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SUBJECT: SBV TRIES TO SLOW CREDIT GROWTH TO FIGHT INFLATION

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REFTEL: A) 07 HANOI 1729
B) 07 HANOI 2013
C) HANOI 193
D) HANOI 210

¶1. (SBU) Summary: One of the main ways that the GNV is trying to tackle the dramatic spike in inflation is by slowing the growth in bank lending. Vietnamese bank lending has been growing at a double-digit pace since 1994, with a larger share of the loan growth coming from joint-stock commercial banks and being given to private enterprises. In an effort to curb lending growth, the GVN so far this year has hiked the official policy interest rates, increased the required reserve ratio, limited bank loans for security-related purchases, and most recently, announced its intention to require larger banks and credit institutions to buy mandatory one-year treasury bills. Notwithstanding these efforts, many analysts expect credit growth to continue the acceleration begun in 2007 into this year. End Summary.

Credit growth re-accelerated in 2007

¶2. (U) Vietnam's banks have been expanding their loan books at a double-digit pace since 1994. Prior to the Asian financial crisis, credit in Vietnam grew at about 20 percent per year. Credit growth peaked in 1999 at 55.3 percent as infrastructure and investment spending took off but moderated thereafter on concerns of too rapid credit growth. From 2004 till 2006, for example, the pace of loan growth slowed from 41.7 percent to 25.4 percent as the SBV raised interest rates to fight a sharp increase in inflation and credit growth. However, credit growth resumed its high growth in 2007, with some analysts estimating credit growth of around 40 percent. Expectations of continuing strong economic growth this year has led Vietnamese banks and financial analysts to project similar credit growth rate in 2008.

Figure: Vietnam's Loan Growth By Type of Borrower
(VND billion)

Year	Total Loan	Growth (%)	Loans to State Enterprises	Growth (%)	Loans to Other Sectors	Growth (%)
1994	33345	n.a.	21004	n.a.	12341	n.a.
1995	42277	26.8	24079	14.6	18198	47.5

1996	50751	20.0	26810	11.3	23941	31.6
1997	62201	22.6	31222	16.5	30979	29.4
1998	72597	16.7	38076	22.0	34521	11.4
1999	112730	55.3	54335	42.7	58395	69.2
2000	155720	38.1	69918	28.7	85802	46.9
2001	189103	21.4	79745	14.1	109358	27.5
2002	231078	22.2	89500	12.2	141578	29.5
2003	296737	28.4	105400	17.8	191337	35.1
2004	420335	41.7	142900	35.6	277435	45.0
2005	553106	31.6	181306	26.9	371800	34.0
2006	693800	25.4	218547	20.5	475253	27.8

Source: CEIC Data Company Ltd.

¶3. (U) Prior to 1999, the bulk of loans were to state enterprises. This is not surprising given that lending decision was state-directed rather than commercially-based. This lopsided lending changed from 1999 onwards as the government reportedly began to withdraw its involvement in the lending decisions of state-owned commercial banks (SOCBs), leading to the private sector gaining a higher share in bank lending than state enterprises. The share of loans going to the private sector was 68.5 percent in 2006 compared to less than 50 percent in the 1990s. Deutsche Bank analysts believe the key segments of credit growth opportunity are private companies, SMEs and consumers and that the historic dependence on SOE borrowing will continue to diminish.

Private banks catching up with SOCBs

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¶4. (U) Vietnam's SOCBs are individually and collectively quite large, accounting for almost two thirds of loans outstanding (see figure 2). Many are growing their loans quite rapidly in an effort to enhance their potential profitability, particularly prior to equitization and listing of their shares. For example, in a recent FINATT trip to Vietnam, Vietcombank said that its loans grew by 49 percent in 2007 as compared to 39 percent in 2006 and the industry average of 40 percent in 2007.

Figure 2: Lending market share by type of bank
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(%)	1994	2000	2001	2002	2003	2004	2005	2006
SOCBs	82.8	73.3	75.8	75.9	72.4	75.0	69.0	63.5
Other Banks - (JSCBs,FBBs & JV Banks)	17.2	26.7	24.2	24.1	27.6	25.0	31.0	36.5

Source: CEIC Data Company, Ltd.

¶5. (U) Joint-stock commercial banks (JSCBs), foreign bank branches and joint venture banks (FBB and JV Banks) - are relative newcomers, but their share of bank loans has increased from a fifth to more than a third since 1994. Lending by these banks has grown by leaps and bounds. Looking ahead, this trend is likely to continue as these banks push aggressively to build up their franchises in Vietnam.

Figure 3: Lending by SOCBs versus Other Banks
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(VND billion)

Year	Total Loan	Lending by State Banks	Growth (%)	Lending by Other Banks	Growth (%)
2001	189103	143355	25.5	45748	10.2
2002	231078	175489	22.4	55589	21.5
2003	296737	214800	22.4	81937	47.4
2004	420335	315335	46.8	105000	28.1
2005	553106	381406	21.0	171700	63.5
2006	693800	440500	15.5	253300	47.5

Source: CEIC Data Company, Ltd.

Policy Response by the Government

¶6. (SBU) In response to increasing inflationary pressures and to curb excessive credit expansion, the State Bank of Vietnam (SBV) has been raising the three official interest rates-- the prime, discount and refinancing rates--in Vietnam since 2007. The SBV's most recent action came in early February when it lifted the prime, discount and refinancing rates to 8.75 percent, 6.0 percent and 7.5 percent respectively. In theory, these rates would be the policy rate, the rate the banks can borrow from the central bank and the rate that banks can borrow for collateralized loans, respectively. According to the IMF Resident Representative, however, none of these rates are "operational" for monetary policy purposes: instead, the SBV carries out its monetary policy by buying and selling SBV bills, which have yields well above all of the "official" rates mentioned above. Thus, while the increases in these official rates provide a signal to the market, they are not actually used to price any transactions between the financial institutions and the central bank.

¶7. (U) The SBV also raised the reserve requirement ratio by an additional one percent to 11 percent in February - after doubling them from 5 percent to 10 percent in the summer of 2007.

¶8. (U) Lastly, and most recently, the SBV announced its intention to require banks and credit institutions with more than VND1 trillion of deposit to buy mandatory treasury bills with the interest rate of 7.8 percent by March 17 (Reftel D). Analysts say this move should withdraw VND20.3 trillion (US$1.26 billion) from the market. Even in advance of this sale, some companies, including banks, are

reporting that they are having difficulty acquiring dong from the SBV.

¶9. (U) In addition to these monetary tools, the SBV has announced changes to banks' lending policy for the purchase of shares. Previously, banks were limited to lending no more than 3 percent of all their lending for shares. Commercial bankers told FINATT that this policy failed to contain credit growth, especially to the stock market, as banks sought to increase their total lending in order to have more to lend for shares. To remedy this situation, the SBV announced in February that banks can make securities-related loans equivalent to 15-20 percent of their chartered capital. HSBC analysts calculated that this will cut the maximum securities-related lending from VND6.5 trillion to VND4.6 trillion. There are now fears that banks will try to get around this new rule by raising their chartered capital, which would create more capacity to increase overall loans, frustrating the SBV's macro-economic goal of slowing credit growth.

¶10. (SBU) Comment: It is natural for credit growth to expand strongly amid robust economic growth and an under-penetrated financial market. The very rapid growth at the smaller private banks is worrisome, however, not only contributing to inflation, but also building up potentially bad debts that will have to be

addressed in the future. Given the banks' ingenious efforts to get around the rules set by the SBV so far, SBV will have to vastly improve its inspection, supervision and enforcement of prudential lending rules to guard against inappropriate levels of lending growth. While the SBV is saying the right things, institutional weaknesses are likely to hamper its ability to fight inflation solely by slowing loan growth. End Comment.

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